**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

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| In the matter of | ) | |
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| Ameritech Operating Companies | ) | |
| Tariff FCC No. 2 | ) | |
| Transmittal No. 1312 | ) | |
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| Nevada Bell Telephone Company | ) | |
| Tariff FCC No. 1 | ) | |
| Transmittal No. 20 | ) | |
| | ) | WC Docket No. 02-319 |
| Pacific Bell Telephone Company | ) | |
| FCC Tariff No. 1 | ) | |
| Transmittal No. 77 | ) | |
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| The Southern New England | ) | |
| Telephone Company | ) | |
| Tariff FCC No. 39 | ) | |
| Transmittal No. 772 | ) | |
| | ) | |
| Southwestern Bell Telephone Company | ) | |
| FCC Tariff No. 73 | ) | |
| Transmittal No. 2906 | ) | |

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**RESPONSE OF SBC COMMUNICATIONS INC. TO OPPOSITIONS OF THE DIRECT CASE**

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**RESPONSE OF SBC COMMUNICATIONS INC. TO OPPOSITIONS TO DIRECT CASE**

SBC Communications Inc., on behalf of the Ameritech Operating Companies, Southwestern Bell Telephone Company, Pacific Bell Telephone Company, Nevada Bell Telephone Company and The Southern New England Telephone Company (collectively "SBC") hereby submits its response to oppositions to its Direct Case.[1]

## I. INTRODUCTION AND SUMMARY

The oppositions in this proceeding raise no novel issues. Rather, they regurgitate the same arguments and the same red herring issues in an effort to delay the effectiveness of SBC's

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[1] Direct Case of SBC Communications Inc. (filed Oct. 31, 2002) (Direct Case).

proposed revisions. These arguments are simply an attempt to divert attention away from the enormous financial crisis that is affecting SBC and the reasonableness of the measures that SBC is proposing to address the situation.

Commenters cannot dispute that the telecommunications industry is in crisis. Dozens of carriers have filed for bankruptcy, over half a million people have lost their jobs, and nearly two trillion dollars in market value has been lost. Ignoring these facts, commenters try to characterize SBC's provisions as unnecessary because of SBC's levels of uncollectibles and revenues over the past years. This argument is completely irrelevant. The relevant and indisputable fact is that SBC has lost hundreds of millions of dollars for services rendered because customers with impaired credit defaulted on their payments. Notwithstanding SBC's level of uncollectibles or revenues, SBC has every right to protect itself from such losses, particularly when the amount of such losses has grown to unprecedented levels.

Nor is it the case that SBC's existing price cap rates are sufficient to protect it from the risk of nonpayment. Price cap regulation in no way ensures that SBC recovers its costs when carriers default on their bills. To the contrary, the essence of price cap regulation is that carrier cost recovery is not guaranteed, but in exchange, carriers are given an incentive to increase their profitability by becoming more efficient. In light of the huge spike in uncollectibles that SBC is experiencing, its only recourse under price caps is to act as any rational and efficient company would and take reasonable steps to address the problem. No carrier will be in business for long if it gives away hundreds of millions of dollars of free service without taking steps to protect itself. Thus, the reasonable measures that SBC is proposing are even more critical because SBC is a price cap carrier without a guaranteed rate of return.

Importantly, some of the same commenters that argue that SBC's credit-impaired provisions are unreasonable have similar protections in their tariffs. The fact that nondominant carriers have implemented such provisions demonstrates that SBC's provisions are warranted and commercially reasonable. Thus, there is no basis for the argument that SBC's proposed tariff provisions are anticompetitive. Further, the fact is all companies, regardless of their status in the marketplace, have the right to take reasonable measures to mitigate bad credit risks. SBC, unlike many of the commenters, cannot refuse to do business with its competitors. SBC is obligated to do business with these companies and thus should be permitted to protect itself from credit risks.

Commenters conveniently ignore the measures SBC has taken to mitigate the impact of its deposit provisions on customers. They ignore the fact that SBC is requesting only a one-month deposit for credit-impaired customers, rather than a two-month deposit which is the industry standard for deposit provisions. They ignore the fact that SBC has tried to limit the applicability of its impaired-credit criteria to only those customers posing the greatest risk to SBC. Instead, they try to couch the $1 million threshold as unreasonable or discriminatory. They ignore SBC's prepayment option, which eliminates concerns that SBC will hold onto customer funds for lengthy periods of time. Further, they ignore the fact that SBC has implemented provisions to ensure that refunds are issued timely.

Instead, commenters try to paint themselves as victims. They argue that SBC's shortened notice period for disconnection and bill payment are insufficient because SBC's bills are inaccurate and carriers would not have sufficient time to raise the funds or notify customers in the event disconnection is necessary. But, as SBC has shown, even with the reduced payment and notice intervals, carriers would still have at least 30 days to pay their bills or notify customers prior to any initiation of disconnection procedures. Carriers are not reasonably entitled to longer payment periods. Further, the overwhelming majority of SBC's issued bills are undisputed and even the amounts that are disputed represent only a negligible amount of the overall bill.

Commenters again argue that SBC's proposed deposit criteria are vague, ambiguous and discriminatory. As SBC has fully demonstrated — on three occasions — its proposed deposit criteria are clear, objective and narrowly tailored. Indeed, its criteria are based on financial industry standards, *not* SBC standards, and thus can hardly be said to be vague or ambiguous, as some commenters claim. Further, only those customers posing a risk of significant nonpayment to SBC for services rendered are impacted. Such tailoring is fully consistent with Sections 201 and 202 of the Act and addresses the concerns raised by commenters.

Finally, commenters argue that SBC's proposed interest rate for deposits and refund provisions is unreasonable. Further, some commenters argue that SBC's proposed revisions contradict the U.S. Bankruptcy Code and run afoul of the Commission's substantial cause jurisprudence. These recycled arguments have already been fully addressed and refuted.

## II. SBC's Impaired Creditworthiness Criteria Are Clear, Objective, and Narrowly Tailored.

Some commenters in this proceeding attempt to characterize SBC's impaired creditworthiness criteria as vague, ambiguous, unnecessary and unreasonably discriminatory.[2] But as SBC has demonstrated repeatedly in this proceeding, none of these claims hold water. SBC's proposed criteria are based on established finanical industry standards for assessing when an entity is in dire financial straits. To suggest that these industry standards are unworkable or faulty, when most non-regulated companies in various industries rely on these very standards for assessing the creditworthiness of customers, is unbelievable. Each criterion proposed by SBC is clear, objective and concrete and forms a sound basis for SBC's impaired-credit criteria. Further, SBC's proposed measures are narrowly tailored to those customers posing the most significant risk to SBC, and importantly provide customers various options to satisfy the one-month payment.

### A. SBC's proposed criteria are valid predictors of a customer's inability to pay its bills.

Several commenters argue that there is no nexus between a company's credit rating and ability to pay its bills.[3] As SBC has previously shown, poor credit ratings are indicative of financial health, and poor financial health is indicative of an inability to pay debt.[4] Industry

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[2] Time Warner Opposition at 7; Nextel Opposition at 4; AT&T Opposition at 25.

[3] Sprint Opposition at 11; Consumer Counsel Opposition at 12; Time Warner Opposition at 8.

[4] Direct Case at 19-20.

analysts have repeatedly confirmed this principle. Moreover, contrary to some commenters' claims, SBC does not have to show that a poor credit rating will *always* result in default.[5] Under the established standard for security deposits, SBC need only show that its provisions are a valid indicator. For example, there is no *guarantee* that a customer with no established credit history would default on its bills. This deposit provision, however, is considered reasonable by the Commission — and the industry for that matter — because it is necessary for companies to avoid credit risks. The same holds true for SBC's proposed credit-impaired criteria.

Further, contrary to the Consumer Counsel's claims, SBC's proposed revisions are not based on speculation.[6] As SBC's experience with WorldCom has shown, poor credit ratings are a valid predictor of a company's inability to pay its bills. WorldCom defaulted shortly after receiving a below investment grade rating. SBC has a right to take measures to mitigate similar losses in the future and has reasonably done so in this proceeding.

It is noteworthy that the carriers opposing SBC's proposed revisions have remained virtually silent on SBC's prepayment option. Why? There is no credible argument that prepayment for services rendered is unreasonable. Indeed that is the payment practice in numerous industries, including cable television and ISP industries. With this option, SBC would apply the prepayment to the ensuing month of service, rather than holding it in reserve or "tying up cash," as some commenters allege. The bottom-line is SBC has proposed reasonable measures in recognition of the cash flow concerns of its customers.

WorldCom and AT&T argue that SBC's existing security deposit provisions are sufficient.[7] This argument is laughable from WorldCom, given that WorldCom currently owes SBC over $200 million dollars for services rendered. SBC's existing tariffs are insufficient

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[5] WorldCom Opposition at 9.

[6] Consumer Counsel Opposition at 5.

[7] AT&T Opposition at 5; WorldCom Opposition at 5.

because they fail to provide SBC any protection when a customer's financial health worsens and the customer defaults shortly thereafter. SBC has been burned for hundreds of millions of dollars in such instances and thus should be able to seek additional protection. Importantly, the proposed deposit provisions are *not* applicable to every customer, as AT&T contends. Rather, they apply only if a customer meets one of the impaired-credit criteria and $1 million threshold, which today limits the applicability of the provisions to a approximately 50 customers.

Sprint argues that SBC's failure to include the Securities and Exchange Commission's (SEC) definition of investment grade renders at least one SBC credit-impaired criteria vague.[8] To the contrary, the SEC's definition of investment grade is widely available[9] and provides SBC's customers with a concrete definition of what constitutes "investment grade" from a governmental perspective. To the extent the Commission determines that SBC should include the SEC's definition in its tariff, SBC will do so.

**B. SBC's proposed revisions are reasonable.**

Commenters raise several arguments challenging the reasonableness of SBC's proposed impaired-creditworthiness criteria. AT&T argues that SBC's proposed deposit provisions are unreasonable because the market for interstate access services is not competitive.[10] First and foremost, SBC has every right to collect payment for services rendered whether or not it operates in a competitive environment. As the FCC has recognized, it is prudent for telephone companies "to seek to avoid non-recoverable costs imposed by bad credit risk," and telephone companies

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[8] Sprint Opposition at 11.

[9] The SEC definition of investment grade, for example, can be found in the general instructions of the S-3 form, which businesses must file with the SEC. The SEC defines investment grade as, "If at the time of sale, at least one nationally recognized statistical rating organization has rated the security in one of its generic rating categories which signifies investment grade; typically, the four highest rating categories signify investment grade."

[10] AT&T Opposition at 6.

may do so via deposit provisions.[11] That is what SBC has always done and that is what SBC is doing here.

Second, SBC does operate in a competitive environment. SBC, for example, has received pricing relief for certain special access and dedicated transport services, which was granted because of the presence of competitors in the marketplace. In fact, roughly one half of SBC's special access services are deemed competitive. End user access services are also becoming increasingly competitive as evidenced by SBC's significant loss of access lines to CLECs.[12] Thus, AT&T is simply wrong in claiming that there is no competition in the interstate access market.

Third, it is notable that many of the same commenters opposing SBC's proposed credit-impaired criteria have similar protections in their tariffs. Sage Telecom has a tariff permitting it to obtain a two-month deposit from customers "who fail to establish creditworthiness or who present an undue risk of nonpayment."[13] Similarly, Level 3's tariff allows it to obtain a deposit from existing customers "when high risk is indicated and existing security is insufficient."[14] SBC is only implementing similar protections here and there is no basis for impugning SBC's actions as anticompetitive.

Other commenters argue that SBC's proposed revisions are unreasonable because SBC is trying to shift its risk of uncollectibles entirely to its customers.[15] The record in this proceeding proves otherwise. SBC's existing tariff provisions enable customers to receive two to three

[11] Investigation of Access and Divestiture Related Tariffs, CC Docket No. 83-1145, 97 FCC Rcd 1083 (1984).

[12] UNE Fact Report 2002-Comments of SBC Communications Inc., in CC Docket 01-338, Section IV. Local Loops, p. IV-8 (Apr. 5, 2002). CLEC Report 2002-Competitive Last Mile providers, Chapter 4: Status of the CLEC industry: Table 25: Access line Growth (2000-2001), Network Parameters New Paradigm Resources Group, Inc. (Vol. 1 16th ed. 2002).

[13] Sage Telecom, Inc. F.C.C. Tariff No.1, § 5.6.

[14] Level 3 LLC, F.C.C. Tariff No.4, § 4.4.3.

[15] ALTS Opposition at 4; Unsecured Creditors at 4.

months of service before SBC can terminate service. SBC's proposed revisions merely *reduce*, not eliminate, this exposure. SBC still risks nonpayment for at least one month of service. SBC is fully aware that as a business it assumes a certain risk of uncollectibles. No company, however, should bear the risk of providing three months of free service.

**C. SBC must be allowed to protect itself from customer defaults.**

Many commenters argue that SBC's proposed revisions are unnecessary because SBC's reported level of uncollectibles is miniscule, its rate of return high, or its price cap rates are sufficient to protect SBC from a high risk of uncollectibles.[16] These commenters ignore the fact that businesses have every right to take reasonable measures to protect themselves from bad credit risks — a fact this Commission has recognized. Arguments that SBC's level of uncollectibles is low and revenues high are therefore irrelevant. The undisputed fact is that SBC has experienced a tremendous spike in uncollectibles, an increase of 373% from 2001 to 2002. This increase in uncollectibles is attributable to a permanent shift in the competitive nature of the telecommunications market and a financial crisis that has caused many customers to stop paying their bills.

The fact that SBC is a price cap LEC is irrelevant. Price cap regulation does not require a carrier to forego measures to ensure payment. If that were the case, no deposit regulations would be reasonable under price caps. To the contrary, the essence of price cap regulation is that carrier cost recovery is not guaranteed. Carriers thus have an incentive to increase their profitability by becoming more efficient. Given its significant increase in uncollectibles, SBC's only recourse under price caps is to do what any rational and efficient company would do which is to take reasonable measures to address the problem.

In any event, SBC's price cap rates do not sufficiently mitigate its risk of uncollectibles. The ongoing effects of customer defaults are not reflected in current price cap rates. Under price

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[16] ALTS Opposition at 6; AT&T Opposition at 12; Nextel Opposition at 5; Sprint Opposition at 19; Time Warner Opposition at 6; WorldCom Opposition at 15.

cap regulation, LEC rates are adjusted to reflect changes in the overall economy. As SBC has already stated in its Direct Case, there is a significant disparity between changes in the overall economy and changes in the telecommunications sector. Because the inflation factor used to calculate rate adjustments is not based solely on the telecommunications sector, the inflation numbers significantly understate changes in the telecommunications marketplace.

Further, any rate adjustment would take place six to eighteen months after the fact. This is because LEC rate adjustments are calculated using the change in the inflation factor, which is calculated as "the percent change in the GDP-PI between the quarter ending six months prior to the effective date of the new annual tariff and the corresponding quarter of the previous year."[17] This, coupled with the fact that the change in the GDP-PI is not representative of changes in the telecommunications sector, means that SBC's price cap rates would not provide it the protection it is requesting here.

Importantly, as SBC demonstrated in its Direct Case, its level of uncollectible expense has increased disproportionately in 2002 — a fact commenters conveniently ignore. The amounts embedded in rates at the inception of price cap regulation in no way captured this level of

[17] 47 C.F.R. § 61.45 (b)(1)(i).

uncollectible expense, particularly those incurred during 2002, and thus clearly is not representative of normal fluctuations.[18]

### D. SBC's proposed revisions are not unreasonably discriminatory.

Several commenters argue that SBC's proposed revisions violate Sections 201 and 202 of the Act because they discriminate against carrier-competitors, and/or unreasonably single out carrier-customers.[19] As SBC has previously shown, the critical inquiry under Sections 201 and 202 is whether a practice or regulation is *unreasonably* discriminatory. SBC's proposed deposit criteria admittedly apply only to customers meeting the $1 million threshold, but this distinction is reasonable and does not single out carrier-customers. SBC has appropriately targeted its provision to those customers that pose the most significant risk of revenue loss to SBC, which today is approximately 50 customers representing roughly 95% of SBC's interstate access

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[18] The chart below reflects SBC's uncollectibles from 1990-2002.

| **SBC Interstate Uncollectible Data As A Percentage of Interstate Revenues 1990-2002** | | | |
|---|---|---|---|
| **Year** | **Interstate Access Uncollectibles** | **Interstate Revenues** | **Uncollectible Ratio** |
| 1990 | 23,024 | 5,991,659 | **0.38%** |
| 1991 | 21,987 | 5,878,025 | **0.37%** |
| 1992 | 21,123 | 5,980,680 | **0.35%** |
| 1993 | 22,338 | 6,295,145 | **0.35%** |
| 1994 | 25,905 | 6,519,373 | **0.40%** |
| 1995 | 16,554 | 6,717,367 | **0.25%** |
| 1996 | 26,896 | 6,978,562 | **0.39%** |
| 1997 | 23,029 | 7,042,184 | **0.33%** |
| 1998 | 21,761 | 7,687,547 | **0.28%** |
| 1999 | 21,373 | 8,254,495 | **0.26%** |
| 2000 | 30,987 | 8,932,712 | **0.35%** |
| 2001 | 48,032 | 9,622,673 | **0.50%** |
| 2002[18] | 237,127 | 6,870,978 | **3.45%** |

While SBC does not dispute that actual uncollectible expenses in Ameritech for 2000 and 2001 are less than the amount included in rates at price cap inception, it is inappropriate to review this data in a vacuum. The foregoing information demonstrates that there were periods where the actual uncollectible expense for Ameritech far exceeded the amount embedded in price caps. Furthermore, January-September 2002 uncollectible expenses for SBC are almost as great as total uncollectible expenses from 1990 to 2001 and certainly exceed amounts embedded at price cap inception.

[19] Sprint at 1& 4; World Com at 2; Nextel at 3.

revenues. In this respect the limit is not only reasonable, but also very much in the public interest as it excludes customers that do not pose a risk of significant nonpayment to SBC.

AT&T argues that SBC's proposal to examine the debt ratings of a customer or its parents is unreasonable and discriminatory because it will excuse deposits from SBC affiliates. Further, AT&T argues that allowing the creditworthiness of SBC's long distance affiliates to be established based on SBC would violate Section 272(b)(4) of the Act.[20] First, SBC affiliates are subject to SBC's impaired-credit criteria just like any other customer. Second, other customers, like SBC's affiliates, can rely on the debt ratings of their parent to show that they are creditworthy, thereby eliminating any disparate treatment. Third, the Commission has already held that Section 272(b)(4) does not forbid a Section 272 affiliate from using assets other than its own as collateral when seeking credit.[21]

## III. SBC'S SHORTENED NOTICE INTERVAL AND BILL PAYMENT INTERVAL FOR CREDIT-IMPAIRED CUSTOMERS IS REASONABLE.

Several commenters challenge the reasonableness of SBC's shortened notice and bill payment intervals. Allegiance and AT&T argue that SBC's proposed shortened notice of disconnection interval could harm carrier-customers because carriers would have insufficient time to notify their customers of disconnection of service.[22] Allegiance argues that the shortened interval for a deposit payment would not provide carriers sufficient time to assess SBC's determination that a deposit is required.[23] Nextel argues that SBC has not demonstrated that the shortened bill payment interval or notice interval will materially reduce its exposure to unpaid

[20] AT&T Opposition at 34-35.

[21] *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, *First Report and Order and Further Notice of Proposed Rulemaking*, 11 FCC Rcd 21905, ¶ 190(1996)(*Non-Accounting Safeguards Order*).

[22] Allegiance Opposition at 5; AT&T Opposition at 37.

[23] Allegiance Opposition at 13-14.

debt.[24] Further, Sprint and Nextel argue that the shortened bill payment interval is unreasonable given the size, complexity and inaccuracy of SBC's bills.[25]

All of the commenters ignore one critical fact. In every instance, SBC will give customers at least 30 days to pay their bill prior to disconnecting service.[26] Thirty days is ample time to assess, pay, or dispute a bill. Moreover carriers are not reasonably entitled to more than 30 days of *free* service and typically do not give *their* customers such free service. Importantly, as SBC has repeatedly stated, carriers can dispute their bills and SBC will *not* initiate disconnect procedures for bill amounts in dispute.

Allegiance is simply wrong that it needs additional time to assess SBC's determination that a deposit is required. SBC's credit-impaired criteria are based on third-party sources that can be easily confirmed by customers. Further, SBC has provided customers several options to satisfy the deposit requirement, several of which do not require an outlay of cash, and a prepayment option.

Contrary to Nextel's claims, the shortened notice periods would significantly mitigate SBC's exposure to nonpayment. As SBC explained in its Direct Case, pursuant to SBC's existing tariffs, it must provide customers at least sixty days of service prior to initiating disconnection, which in reality often results in closer to three months of service.[27] The shortened notice and bill payment intervals reduce this risk in half, permitting SBC to take action to minimize its losses after a month of nonpayment.

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[24] Nextel Opposition at 16.

[25] Sprint Opposition at 4; Nextel Opposition at 16.

[26] Customers have 21 days to pay their bills, plus an additional ten days to pay before disconnection procedures begin.

[27] Direct Case at 14.

## IV. SBC'S PROPOSED INTEREST RATE FOR DEPOSITS AND REFUND PROVISIONS IS REASONABLE.

Most commenters provide no new arguments regarding SBC's proposed interest rate for deposits or refund provisions. SBC has fully supported and justified those provisions in its Direct Case, Description and Justification and SBC Opposition to Petitions to Reject, or, in the Alternative, Suspend SBC's Tariffs and thus will not belabor the issues here.

It is puzzling that ALTS challenges SBC's proposal that the *customer* should demonstrate when a deposit is no longer required.[28] SBC will implement procedures to periodically review the need for retention of the deposit, but this may delay the refund of deposits in some cases. For example, if SBC reviews accounts quarterly, a customer could conceivably have to wait several months to receive its refund. The better approach is for the customer, rather than SBC, to initiate the refund since customers are in the best position to determine when their credit or payment conditions have improved. Importantly, under SBC's proposed provisions, SBC would have to refund the deposit within 21 days of such demonstration.

Allegiance argues that a customer should be able to overcome an "arbitrary creditworthiness determination by SBC" with a subsequent record of prompt payment.[29] Far from being arbitrary, SBC's impaired-credit criteria are based wholly on established industry standards. There is no subjective analysis performed by SBC in determining whether a deposit is warranted. Further, SBC's late payment deposit provisions and impaired-credit provisions are distinct. A prompt payment history in no way diminishes the bad credit risk posed by companies with poor credit ratings, which is the issue SBC seeks to address with its credit-impaired deposit criteria.

[28] ALTS Opposition at 9.

[29] Allegiance Opposition at 23.

## V. SBC'S PROPOSED DEPOSIT PROVISIONS DO NOT TRIGGER THE SUBSTANTIAL CAUSE TEST.

Allegiance and WorldCom argue that SBC's proposed deposit provisions constitute material changes to SBC's term plans, triggering the substantial cause test, and SBC has failed to show substantial cause.[30] As SBC previously demonstrated, revisions to its general regulations are not applicable to its term plans, thus the substantial cause test is not invoked.

The *RCA Americom* cases establish when and in what manner the substantial cause test will be applied.[31] As *RCA Americom* makes clear, the substantial cause test is invoked where a carrier proposes modifications to the terms of a long-term service arrangement. Specifically, the Commission analogized long term service arrangements to service contracts. The Commission concluded that with long term service arrangements, the carrier "offers definite terms for a fixed period . . .[and] the customers then decide whether to accept the offer based upon whether the offering meets their needs at a price they are willing to pay."[32] Thus, the critical question is whether SBC's deposit provisions are definite terms that have been included in SBC's term plans.

The answer is no, and no commenter has pointed to any tariff language showing otherwise. Rather, commenters argue, in effect, that *any* term or condition set forth in SBC's tariffs is incorporated in SBC's term plans and cannot be modified.[33] This argument is nonsensical and further flies in the face of Commission actions to the contrary. As SBC has previously shown, the Commission has permitted changes to the general regulations of a tariff without a showing of substantial cause, and such changes have been applicable to term customers.[34] SBC is requesting nothing more here.

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[30] Allegiance Opposition at 7: WorldCom Opposition at 13-14; Sprint Opposition at 18.

[31] *RCA American Communications, Inc.*, 86 FCC.2d 1197 (1981).

[32] *Id.* at 1202.

[33] Allegiance Opposition at 7; Sprint Opposition at 18; WorldCom Opposition at 13-14.

[34] *See* Direct Case at 38; SBC Opposition to Petition to Reject or, in the Alternative, Suspend at p. 23.

SBC's general tariff regulations and amendments thereto, apply to all customers, including term plan customers, except where the term plan provides otherwise. Thus, to determine what other conditions, benefits, or price reductions are specific to a term plan customer, one must look specifically to the terms of the term plan. If a particular term is not expressly incorporated in the term plan, the term plan customer has no reasonable expectation that the particular condition will not change. Importantly, month-to-month customers and term plan customers are treated in the same manner under SBC's tariffs, except where the term plan provides otherwise. Otherwise, SBC's entire interstate access tariff could be considered a term plan, which it certainly is not.

Further, even if SBC's proposed changes were applicable to term plan customers, such changes are not "material" changes invoking the substantial cause test.[35] As SBC has previously shown, SBC's proposed changes are not critical to any customer decision to take a term plan because they apply whether you are a term plan customer or not.[36] Critical components, on the other hand, provide term plan customers terms and conditions that are not already available to month-to-month customers.

In any event, if the Commission concludes that the substantial cause test is triggered, SBC has made the requisite showing. WorldCom and Allegiance argue that SBC has failed to satisfy the first prong of the substantial cause test, i.e. there are factors necessitating a change in SBC's deposit policies at this time.[37] According to WorldCom, SBC has made only generalized assertions of potential harm which do not satisfy the substantial cause standard.[38] Sprint argues

[35] Direct Case at 36.

[36] *Id.*

[37] Allegiance Opposition at 7; WorldCom Opposition at 13-14.

[38] WorldCom Opposition at 13.

that SBC's low level of uncollectibles show that SBC has not experienced a significant harm for purposes of the substantial cause test.[39]

SBC fully demonstrated in its Direct Case that it has substantial cause to make the proposed revisions, and thus will not belabor the issue here.[40] Importantly, SBC has experienced first hand significant nonpayment for services rendered from several of its largest customers. This huge spike in uncollectibles was substantial and unforeseeable. SBC is now in a position where some of its largest customers are unable to pay their bills, which is significant and not addressed by SBC's existing tariffs. SBC should be permitted to take measures to mitigate its risk.

## VI. SBC'S PROPOSED DEPOSIT PROVISIONS ARE FULLY CONSISTENT WITH THE U.S. BANKRUPTCY CODE.

Several commenters argue that SBC's bankruptcy trigger conflicts with the U.S. Bankruptcy Code.[41] These commenters clearly misunderstand the fundamental nature of the Bankruptcy Code, and particularly, Section 366.[42] There is nothing "unlawful" about SBC's proposed impaired-credit criteria as they apply to customers subject to a bankruptcy proceeding. Rather, as set forth in SBC's Direct Case, SBC is asking the Commission to exercise its ratemaking authority and provide for a deposit in instances where the customer (or its parent) has filed for bankruptcy because in such instances it is highly likely that the customer would not be able to pay its bills, thus warranting a deposit.

Not surprisingly, no commenter cites to any case that holds that a tariff provision providing for a security deposit based upon credit worthiness, including the filing of a

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[39] Sprint Opposition at 6.

[40] *See* Direct Case at 37.

[41] *See e.g.* Opposition to Direct Case filed by the Official Committee of Unsecured Creditors of WorldCom, Inc. ("Committee Submission").

[42] Commenters assume for purposes of their submission that the affiliated entities of SBC are utilities within the meaning of the Bankruptcy Code. For purposes of this response only, SBC will make the same assumption.

bankruptcy petition, is "unlawful." In fact, whether or not a tariff contains such a provision, once a customer files a bankruptcy petition, it is perfectly permissible for a utility to demand a security deposit as "adequate assurance" for the provision of services to a debtor post-petition.[43] And, contrary to the assertions made in the Committee Objection, the determination of adequate assurance is not the sole province of the bankruptcy court; rather, as clearly articulated in the case law cited *infra*, the bankruptcy court may not even be involved in a determination of adequate assurance.

Section 366(b) of the Bankruptcy Code is self-executing and requires no court intervention.[44] Thus, a debtor customer has the burden to furnish adequate assurance of payment within 20 days, and the utility need not make a formal request of the debtor.[45] Failure to provide adequate assurance permits the utility to unilaterally terminate service to the debtor.[46] Importantly, in the first instance, it is the utility, not the debtor or the court, that determines the amount of security that will suffice under Section 366.[47] Only if a party-in-interest seeks a hearing on the issue of adequate assurance (upon proper notice and a hearing), will the Court determine whether any reasonable modification of the security the utility has deemed adequate is appropriate.[48]

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[43] *In re Northwest Recreational Activities, Inc.*, 8 B.R. 7 (Bankr. N.D. Ga. 1980).

[44] *Carter v. South County Water System (In re Carter)*, 133 B.R. 110,112 (Bankr. N.D. Ohio 1991).

[45] *In re American Investcorp & Dev. Co.*, 155 B.R. 300, 301 (Bankr. D. R.I. 1993).

[46] *In re Stagecoach Enterprises, Inc.*, 1 B.R. 732, 734 (Bankr. M.D. Fla. 1979).

[47] *Id.* at 734 (" . . . once the twenty-day period has expired, the utility is in the driver's seat and may alter, refuse, or discontinue service as it sees fit unless the debtor has furnished the adequate assurance of payment demanded by the utility. If the debtor, the creditor's committee, or other party in interest is dissatisfied with the 'adequate assurance of payment' demanded by the utility, then such party may apply to the court for an order seeking a reasonable modification of it").

[48] *In re Stagecoach*, 1 B.R. at 734; 11 U.S.C. § 366 ("On request of a party in interest and after notice and a hearing, the court may order reasonable modification of the amount of the deposit or other security necessary to provide adequate assurance of payment.")

Courts that have considered whether any reasonable modification is required under Section 366 of the Bankruptcy Code look to many factors, including applicable tariffs.[49] Indeed, at least one bankruptcy court has acknowledged the critical role that regulatory authorities have in setting permissible rates, terms and conditions that both ensure a reasonable rate of return for the utility's shareholders and attempt to avoid losses caused by bankruptcy debtors. As the United States Bankruptcy Court for the Western District of New York so aptly observed:

> We also know that in New York State, public utilities such as NYSEG are subject to the provisions of the Public Service Law and are regulated by the Public Service Commission. This comprehensive regulation includes the setting of permissible rates, which allow for a reasonable rate of return to the utility's shareholders. Losses incurred by these public utilities because of defaults by residential customers, including post-petition defaults by customers who have filed bankruptcy cases, must be a factor which is taken into account as part of the comprehensive regulation by the Public Service Commission and by the New York State Legislature when it periodically reviews and amends, as necessary, the [New York Public Service Law]. That being the case, although I agree that the Bankruptcy Court is not bound by Section 36 of the [New York Public Service Law], the two-month maximum deposit provided for in that section in the case of a delinquent residential customer is a factor which this Court will consider.[50]

Based on the factors considered in a Section 366 determination, including the applicable regulatory requirements, many courts would find that SBC's proposed tariff revisions, which require only a one-month deposit or prepayment of one month's service charges, are not unreasonable and would require no modification.[51]

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[49] *In re Houdashell*, 7 B.R. 901 (Bankr. W.D. Mo. 1981) (court ordered deposit of two times debtor's highest bill in preceding twelve months taking into account, *inter alia*, unpaid prepetition balance, record of payment and deposit mandated by state regulations.)

[50] *In re Spencer*, 218 B.R. 290, 293 (Bankr. W.D.N.Y. 1998). The primacy of regulatory authorities in setting rates, even as to a debtor, is expressly recognized by Congress. Section 1129(a)(6) of the Bankruptcy Code makes confirmation of any plan of reorganization that contains a rate change expressly subject to the prior or subsequent approval of any governmental regulatory commission with jurisdiction over the debtor's rates.

[51] *Id.* at 293 (deposit of two highest months' usage); *Lloyd v. Champaign Tel. Co.*, 52 B.R. 653, 655 (Bankr. S.D. Ohio 1985) (deposit of 2.3 times average usage); *In re Sun-Tel Communications., Inc.*, 39

Citing recent decisions of the Southern District of New York and ignoring other jurisdictions, commenters also argue that the adequate assurance required by Section 366 does not mandate a security deposit. This is not dispositive of or even relevant to whether the Commission, in the exercise of its ratemaking authority, should approve the proposed tariff revisions, but it is also incorrect as a matter of statutory interpretation.[52] Congress has explicitly stated that "adequate assurance of payment in the form of a deposit or other security" is what is required.[53] As the Chief Judge of the United States Bankruptcy Court for the District of Delaware has explained:

> I do not believe that those cases which say that a good history, prepetition history of utility payment and a strong liquidity position is assurance enough. I just don't think the language at 366(b) support that, those cases. And I think that Congress has just very explicitly stated that a deposit or other security is required. That's the only basis for providing adequate assurance. It is not acknowledgement of a priority claim. It is not a handholding comfort level. I think the language is very clear that a deposit or other security is required. And I read 366(b) when it uses the term security as security in the UCC sense of a collateral or a property interest. So, for example, you could furnish the comfort by a letter of credit.[54]

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B.R. 10 (Bankr. S.D. Fla. 1984)(deposit of approximately two months usage); *In re Stagecoach*, 1 B.R. at 736 (deposit of two billing periods).

[52] *United States v. Ron Pair Enterprises, Inc*., 489 U.S. 235, 241, 109 S.Ct. 1026, 1030 (1989) ("[W]here, as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms'"); *In re First Merchants Acceptance v. J.C. Bradford & Co.*, 198 F.3d 394, 403 (3rd Cir. 1999) ("only absurd results and 'the most extraordinary showing of contrary intentions' justify a limitation on the 'plain meaning' of the statutory language" citing *Garcia v. United States*, 469 U.S. 70, 75, 105 S.Ct. 479, 482 (1984).

[53] 11 U.S.C. § 366 (b).

[54] *In re Weiner's Stores, Inc.*, Case No. 95-417 (PJW), June 9, 1995 Transcript at pages 70-71; Accord *In re Armstrong World Industries,* Case No. 00-4471 (JJF), March 7, 2001 Transcript at page 42 ("But I know out there in the world there is some dispute between utilities and debtors in the District of Delaware about 366, particularly (b). So I've been reading this. It's not that many words, but I read it a lot of times over the weekend, and it says --and that's what I'm focused on -- 'such utility may alter, refuse or discontinue service if neither the trustee' – and understand the Third Circuit, we now read statutes, particularly in the bankruptcy context, literally. It doesn't matter, anything, legislative history, all of that is out. You have to keep reading words to understand them -- 'within 20 days after the date of the order for relief, furnishing' here is the key words-- 'adequate assurance of payment.' So you've got to do that in the form of a deposit or other security. But it doesn't say finding that the debtor's going to be okay to pay. It says 'a deposit or other security for service after such date.'"); *In re Best Products Co*., 203 B.R.

Indeed, Section 366 was intended to codify decisions under the former Bankruptcy Act holding that the court did not have jurisdiction to order continued service without a deposit reasonably related to post-filing service.[55] Accordingly, the proposed tariff revisions are not antithetical to the Bankruptcy Code, but rather are in harmony with Section 366.[56]

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51 (Bankr. E.D. Va. 1996) (court "must construe the term 'other security' in accordance with its ordinary or natural meaning. In the utility context, courts appear to have implicitly construed the term 'other security' to mean prepayment of bills, shortened payment deadlines, a letter or credit, a surety bond, or some similar financial device. I hold, therefore, that adequate assurance under § 366 requires more than administrative priority.")(citations omitted); *In re 499 W. Warren Street Associates Ltd.*, 138 B.R. 363, 366 (Bankr. N.D.N.Y. 1991) (requiring security deposit despite finding that debtor is solvent and has the ability to meet its post-petition obligations to utility because "this does not eliminate [the utility's] right to adequate assurance under Code § 366(b). Instead it merely reduces the level beyond which demand for a deposit would be exorbitant under the circumstances"); *In re Smith, Richardson & Conroy*, 50 B.R. 5, 6 (Bankr. S.D. Fla. 1985)(rejecting cases that do not require a security deposit); *In re Stagecoach*, 1 B.R. at 734 (debtor should pay its bills on a current basis and should furnish adequate assurance in the traditional forms of a cash deposit, payment bond or some similar device).

[55] *In re Smith, Richardson*, 50 B.R. at 6 (Section 366 prompted by decisions under Bankruptcy Act, such as *In re Security Investment Properties, Inc.*, 559 F.2d 1321 (5th Cir. 1977), which held that public utility has no duty to provide unsecured future service to a debtor.).

[56] The Committee also argues, without citation to any case law, that the proposed tariff provision somehow frustrates the objectives of the Bankruptcy Code and impermissibly discriminates against debtor customers. Committee Objection at pp. 11-12. As a security deposit is explicitly contemplated by Section 366, this argument is nonsense. *See e.g. In re Smith, Richardson*, 50 B.R. at 6 (Section 366 "recognizes that a utility may discriminate against a debtor solely on the basis of the commencement of a case by requiring adequate assurance of future payment by a deposit or other security").

## VII. CONCLUSION

For the foregoing reasons, the Commission should find that SBC's proposed security deposit and interval provisions are reasonable and permit SBC's tariffs to take effect.

Respectfully Submitted,

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November 21, 2002

## Certificate of Service

I, Lacretia Hill, do hereby certify that on this 21st day of November, a copy of the foregoing "Reply to Oppositions" was served U.S. Mail to the parties listed on the attached sheets.

/s/ Lacretia Hill__________
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